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SUBJECT: WELCOME TO ECUADOR CHAIRMAN THOMAS DELEGATION

Welcome to Ecuador!

11. (U) Chairman Thomas and other Ways and Means Committee Members, we look forward to your visit to Ecuador. Unfortunately, I will have to miss your visit as I move on to my next assignment; however, you will be in the very capable hands of our mission in Ecuador. Your full agenda will include a meeting with President Alfredo Palacio, who took the reins from former President Lucio Gutierrez, when he was ousted on April 20th. Unfortunately, that is nothing new in Ecuador. The last three elected presidents have failed to complete their terms in office. Indeed, in the last 105 years, Ecuador has had 49 governments and 19 constitutions.

Palacio Separating Himself from Gutierrez

12. (SBU) Palacio was Vice President to Gutierrez, but was never really on the inside of the Gutierrez administration. Credible rumors abound about Palacio playing a part in the early departure of Gutierrez, but many breathed a collective sigh of relief when Gutierrez departed the scene. Once again, Ecuadorians believed that a scandal-ridden administration had been replaced by a caretaker government that would certainly last the remaining 20 months of Gutierrez's term. In reality many of the middle class just never liked Gutierrez, generally viewed as an interloper from the hinterlands of Tena. However, Palacio, a medical doctor, is more inclined to the pomp and circumstance of the office than to the day-to-day running of the country. He has publicly commented that he has more important things to do (referring to his medical practice) than being president. Thus, it is by no means certain that he will last for the duration of the Gutierrez's un-expired term. Threats from Gutierrez to return are not helping matters.

13. (SBU) In economic policy, Palacio has taken a divergent and unsettling path from his predecessor. Financial markets were pleasantly surprised by Gutierrez's commitment to sound fiscal policies; though, like most Ecuadorian governments, structural economic reforms remained elusive. In contrast, Palacio's Minister of Economy and Finance Rafael Correa at first threatened to halt debt payments to multilateral financial institutions unless they made new disbursements to Ecuador. While Correa has backed off from such statements, the new administration sponsored legislation that will cut Ecuador's debt reduction payments at least in half.

14. (SBU) Correa is from the old, old school of economics. He believes that the state, not the private sector, should create jobs, increase production and, apparently, control much of the nation's wealth. Correa is the architect of the recent legislation to shift oil revenues from debt reduction to current and capital spending. His ideas for spending include providing \$40-50 million dollars to the banana sector, much of which is controlled by Ecuador's richest man and perennial presidential candidate Alvaro Noboa. Correa has also proposed to invest social security reserves in state oil company PetroEcuador, which has seen its production consistently decline over the past decade, the bulk of it due to corruption, mismanagement and inefficiency. Talk of private investment in the oil sector has all but disappeared. Many think that Correa, who is quite charismatic, has visions of becoming Ecuador's next president. He was against dollarization and no fan of an FTA either. We have asked President Palacio's office to include Minister Correa in Palacio's meeting with you.

15. (SBU) Palacio is most interested in establishing a national health care system and he is critical of intellectual property protections for pharmaceutical drugs. His support of an FTA has been lukewarm, at best. In private he says that he is for the FTA, but he has not publicly advocated on its behalf. However, he has backed off on his earlier statements to submit the FTA to a national referendum.

FTA - Hope for the Future

16. (SBU) Palacio's close friend and Minister of Trade Oswaldo

Molestina is one of the brighter lights in his cabinet. A low-key, serious man, Molestina does not seek the limelight and appears sincere about his desire to reach an FTA with the United States. The tenth round of the FTA negotiations held in Guayaquil June 6-10 was Molestina's first foray into the negotiations, and Ecuador received high marks for its preparation and participation in the round. Though he is now Ecuador's lead negotiator, Molestina wisely kept on former lead negotiator Cristian Espinosa as his technical advisor on the FTA. A commission of private sector representatives has also been appointed to advise Molestina. You should meet with all of them on July 6.

17. (U) Agricultural issues and intellectual property rights are the two toughest topics to resolve. Molestina will likely raise those issues with you and may ask for assistance to improve Ecuadorian competitiveness.

18. (SBU) On our side of the ledger, we are concerned about labor rights in Ecuador, particularly the right to organize, and a number of commercial disputes. Ecuador has an antiquated labor code and a reform of the code would allow both labor and business to benefit. The new Minister of Labor recently told us that both sides have expressed a willingness to look at labor code reform, a promising development.

19. (U) You will hear first-hand about the numerous commercial disputes in the country when you have lunch with the US Business Executive Committee of the Ecuadorian-American Chamber of Commerce. Perhaps the most immediate threat is to Occidental Petroleum (Oxy). Procurador General Jose Maria Borja (Solicitor General equivalent) stated last year that there were grounds to void Oxy's contract and seize its considerable assets in Ecuador. Borja launched an investigation of Oxy after it won a \$75 million international arbitration award against the government of Ecuador. Thus far, we have successfully held off the contract nullification and expropriation of Oxy, but the matter is still before state-owned PetroEcuador and the Minister of Energy to decide. We have warned the government that there will be dire consequences if it attempts to expropriate Oxy's assets.

110. (U) You are also likely to hear from EDC/Noble Energy about their Machala Power plant, payment arrears and subsidy problems. Chevron Texaco, fighting a multi-billion dollar lawsuit in the northern part of Ecuador, will also send a representative. Gallo Winery, Interagua/Bechtel and Latin America Telecom are among the other companies with commercial dispute problems in Ecuador. Molestina is trying to establish an ombudsman type office to work solely on resolving commercial disputes.

111. (SBU) A large segment of the Ecuadorian public still lacks sufficient information about an FTA. We have engaged in an education campaign and the government of Ecuador has been even more active. Still, old prejudices die hard and in the end, Ecuador may not sign an FTA until Peru and Colombia are on board.

ATPDEA Another Incentive -----

111. (U) Ecuador has benefited greatly from the Andean Trade Promotion and Drug Eradication Act (ATPDEA). Two of the greatest beneficiaries are the flower and tuna industries. Those two sectors are among the strongest advocates of the FTA, because they realize what they have to lose when ATPDEA benefits expire at the end of 2006. You are almost certain to hear during your meeting with Molestina about Ecuadorian desires to have in any FTA at least the benefits they now receive under ATPDEA and a request to include similar benefits for canned tuna.

FTA - An Opportunity to Increase Stability -----

112. (SBU) Political and economic stability in this country are nearly as rare as the blue-footed boobies of Ecuador's Galapagos Islands. While we advocate free trade for the obvious benefits it brings, we are also quick to point out that an FTA alone will not be enough. Structural reforms, better health and education, and a responsible, honest and transparent government are all key ingredients to sustainable development, a just society and a higher standard of living.

113. (SBU) An FTA institutionalizes reforms that can lead to greater stability, by adding certainty to trade. Those benefits can be hard to measure. Many socio-economic observers argue that had Ecuador not been dollarized it would have seen even more turmoil in recent years. Dollarization, though not for everyone, has eliminated some of the uncertainty of economic policies that change as frequently, or more often, than governments here. Increased economic certainty and opportunity inevitably lead to increased political stability. We gain from greater regional

stability, better treatment of Americans doing business here and by creating better opportunities for all Americans. We welcome your visit here as another excellent opportunity to demonstrate the benefits of free trade and a vibrant democracy.

Kenney